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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

NO. 959

REUBEN B. WHEATLEY, Commissioner of Finance,
Petitioner,

v.

CHICAGO BRIDGE & IRON COMPANY, LTD.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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TWENTIETH CENTURY PRESS, INC., CHICAGO 60606

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OPINIONS BELOW

The district court's opinion is reported at 295 F.Supp. 240, rather than 395 F.Supp. 240 as stated in the petition. The appellate court's opinion is reported at 430 F.2d 973.

REASONS WHY THE CAUSE SHOULD NOT BE REVIEWED

There Is No Conflict Between the Circuits On the Same Matter

Sayre and Chicago Bridge Involve Different Internal Revenue Code Provisions.

Petitioner argues (pp. 5-6) that the Third Circuit's decision in this case is "squarely in conflict" with the Ninth Cir-

cuit's decision in *Sayre & Co.* v. *Riddell*, 395 F.2d 407 (1968) because both "courts were interpreting the same section [7701(a)(4)&(5)] of the Internal Revenue Code" in applying the so-called mirror system of taxation to the Virgin Islands and Guam, respectively.

Section 7701(a)(4) & (5), part of the definitional section of the Internal Revenue Code of 1954 (26 U.S.C.), provides:

> Sec. 7701. Definitions.
>
> (a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—
>
> • • •
>
> (4) DOMESTIC.— The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State or Territory.
>
> (5) FOREIGN. — The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

In *Sayre*, the Ninth Circuit held that a Hawaiian corporation was not a "domestic" corporation within the definition of (4)—and therefore that it was a "foreign" corporation under the *definition* of (5)—for the purpose of applying *substantive* §§ 881 and 1442 of the Internal Revenue Code, when considered as the Guam income tax law under the mirror system of taxation. Section 1442 provided for the withholding, at the source, of the 30% tax imposed by § 881 on interest, dividends, etc. received from "sources within the United States" by a "foreign corporation." The effect of the Ninth Circuit's decision was to hold that interest payments by a Guamanian citizen to the Hawaiian corporation were subject to the 30% Guamanian withholding tax; just as such payments by a United States citizen to a Guamanian corporation would be subject to the 30% United

States withholding tax (see Rev. Rul. 56-616, 1956-2 Cum. Bull. 589).

In the case at bar, the Third Circuit held that Chicago Bridge (a Delaware corporation) was a "domestic" corporation under the *definition* of (4), for the purpose of applying *substantive* §§ 921 and 922 of the Internal Revenue Code, when considered as the Virgin Islands income tax law under the mirror system of taxation. Sections 921 and 922 (Pet. App. 18a-19a) provide for a special deduction, in computing taxable income, to qualified Western Hemisphere trade corporations—namely, "domestic" corporations doing business only in the Western Hemisphere whose gross income comes (1) 95% from "sources without the United States" and (2) 90% from the active conduct of trade or business. The effect of the Third Circuit's decision is that the Western Hemisphere trade corporation deduction is available to a qualified United States corporation in computing its taxable income for the purpose of filing a Virgin Islands income tax return on its Virgin Islands-source income; just as the Western Hemisphere trade corporation deduction is available to such a corporation in computing its taxable income for the purpose of filing its United States tax return on its income from *all* sources.

Thus, while both cases involve the interpretation of the "domestic" and "foreign" corporation *definitions* of § 7701-(a)(4) & (5), they involve entirely distinct *substantive* provisions of the Code, having quite different origins and purposes. Only in the most superficial sense can it be said that the two courts were interpreting the "same section" of the Code. And in no way can it be said that there is a conflict between the two courts "on the same matter" within the meaning of conflict-between-circuits provision of this Court's Rule 19(b).

Sayre and Chicago Bridge Are Not in Conflict.

But even if petitioner's sophistic definition of the "same section" of the Code were to be accepted, there is no real conflict between the two decisions.

The Third Circuit accepted the fundamental principles of *Sayre* that the purpose of the mirror system of taxation is to give the territory "a separate, integral tax system, which would duplicate the United States' tax system in all substantive particulars," so that the territory would collect a tax "equivalent to what the United States would collect on the same income, but for the mirror system"; and that "some substitution of language" is required so that the territory is enabled to "apply the Internal Revenue Code . . . to persons and income within its territory just as the United States applies the Code to persons and income within *its* territory." (Pet. App. 11a, 13a, 14a.) Indeed, the Third Circuit expressly stated that it was "apply[ing] these concepts to the present problem." (Pet. App. 13a.)

The difference between the two cases is that the Ninth Circuit felt that "Guam" had to be substituted for "United States" in § 7701(a)(4) & (5) for the purpose of determining what was a "foreign" (non-domestic) corporation subject to the 30% Guamanian withholding tax on Guam-source income under § 1442; otherwise, interest payments by a Guamanian to a United States corporation, being deductible by the Guamanian for Guam income tax purposes, would entirely escape taxation by Guam, thus defeating the purpose of the § 881 tax on interest payments to foreign corporations. *Sayre & Co.* v. *Riddell,* 395 F.2d at 409. Moreover, this result is but the reciprocal of what happens when a United States citizen makes interest payments to a Guamanian corporation. Rev. Rul. 56-616, 1956-2 Cum. Bull. 589.

On the other hand, the Third Circuit felt that it was not necessary to substitute "Virgin Islands" for "United States"

in § 7701(a)(4), for the purpose of determining what is a "domestic" corporation under § 921, entitled to the § 922 Western Hemisphere trade corporation deduction; for the substitution would defeat—not effectuate—the purpose of the Western Hemisphere trade corporation deduction and could lead to even more serious consequences. (Pet. App. 14a-15a.) Moreover, this result would distort the mirror system of taxation by allowing the Virgin Islands to collect a greater tax than the United States would have collected in the absence of the mirror system. (Pet. App. 14a.)

Thus *Sayre* and *Chicago Bridge* merely represent discriminating—not blind—applications of the rule that, in applying the United States Internal Revenue Code as a territorial income tax law, substitution of references to the particular taxing jurisdiction should be made only where *necessary* to give proper effect to the *substantive* provisions of the statute. I.T. 2946, XIV-2 Cum. Bull. 109 at 110; 48 U.S.C. § 1421i(e); *Wilson* v. *Kenedy*, 123 F.Supp. 156, 160 (Guam, 1954), aff'd, 232 F.2d 153 (9th Cir. 1956). Otherwise, the *substantive* provisions of the Code are to be applied literally and in their entirety. *Bromberg* v. *Ingling*, 300 F.2d 859, 862-863 (9th Cir. 1962); *Government of Guam* v. *Kaanehe*, 137 F.Supp. 189, 190 (Guam, 1956).

Sayre and Chicago Bridge Were Both Correctly Decided.

Petitioner's discussion of the concept of "evenhandedness" (Pet. 7-8) is based on a fundamental misconception of the purpose of the mirror system of taxation, which is to create a territorial tax "measured by the Federal tax." *Laguana* v. *Ansell*, 102 F. Supp. 919, 921 (Guam, 1952), *aff'd per curiam*, 212 F.2d 207 (9th Cir. 1954), *cert. denied*, 348 U.S. 830 (1954); *Wilson* v. *Kennedy*, 123 F.Supp. 156, 160 (Guam, 1954), *aff'd*, 232 F.2d 153 (9th Cir. 1956); *Pacific Wholesalers* v. *Mangerich*, 147 F.Supp. 867, 868 (Guam, 1957).

This purpose was effectuated in *Sayre* by allowing Guam to withhold the *same* tax on interest payments by a Guamanian citizen to a United States corporation as the United States would have withheld on interest payments by a United States citizen to a Guamanian corporation. This purpose was effectuated in *Chicago Bridge* by allowing the Virgin Islands to collect the *same* tax on Chicago Bridge's Virgin Islands-source income as the United States would have collected absent the statute (48 U.S.C. § 1397 (Pet. App. 18a)) allowing the Virgin Islands to collect all taxes on Virgin Islands-source income.

Petitioner argues for the right of the Virgin Islands to impose a *greater* tax by erroneously stating, without citation (Pet. 7), that *Sayre* upheld "Guam's imposition of a total tax substantially exceeding the tax which the United States would have imposed on the same taxpayer." The 30% withholding tax on dividends, interest etc. paid by a domestic taxpayer to a foreign corporation is imposed on the foreign corporation (I.R.C. § 881), but must be withheld by the domestic payor at the source (§ 1442). Therefore, for Guam income tax purposes, the 30% tax on interest paid by the Guamanian citizen to the Hawaiian corporation was imposed on the Hawaiian corporation, which would have to treat the gross interest payment as income, subject to a foreign tax credit for the 30% deducted and withheld by the Guam payor. I.R.C. § 901(b)(1). Since the United States corporate tax rate (48%) is more than the 30% withholding tax (offset by the foreign tax credit), the United States taxpayer did not bear a Guam tax burden greater than his United States tax burden would have been absent the imposition of the Guam withholding tax; the burden was exactly the same.

Petitioner's concept of "evenhandedness" seems to be one of reciprocity, rather than equality of tax burden: If a Virgin Islands corporation cannot qualify as a Western

Hemisphere trade corporation for United States tax purposes (and is, therefore, taxed at the 48% rate), neither should a United States corporation be able to qualify as a Western Hemisphere trade corporation for Virgin Islands tax purposes. (Pet. 8.) This argument completely ignores the fact that, since 1954, § 28(a) of the Revised Organic Act of the Virgin Islands (68 Stat. 497; 48 U.S.C. § 1642) has provided that permanent residents of the Virgin Islands (including corporations) file no United States income tax returns; instead, they file Virgin Islands income tax returns on all of their income, regardless of source.* Thus, there is no reciprocity involved.

As the Third Circuit correctly found (Pet. App. 15a), if petitioner's substitution argument should be accepted, a Virgin Islands corporation with only United States-source income would be taxed by the Virgin Islands at the lower Western Hemisphere trade corporation 34% rate on *all* of its income. This would distort the purpose of the Western Hemisphere trade corporation deduction, which is to subsidize United States corporations doing business in the Western Hemisphere *outside* the United States. Moreover, it would undoubtedly result in the Virgin Islands becoming the most popular place of incorporation for all corporations doing business in the United States. On the other hand, as the Third Circuit held, not making the substitution effectuates both the purpose of the Western Hemisphere trade corporation deduction and the purpose of the mirror system of taxation to allow the territory to collect the same tax the United States would otherwise have collected. (Pet. App. 14a, 16a.)

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* Petitioner's statements (Pet. 8) that a Virgin Islands corporation "cannot qualify as a WHTC for United States tax purposes" and "is taxed * * * at the general corporate rate of 48 percent for United States tax purposes" are unintelligible in the light of the fact that Virgin Islands corporations do not file United States tax returns.

Petitioner's Threat-to-the-Revenue Argument Is Misdirected

Relying on a self-serving letter written by petitioner himself (Pet. App. 20a)—which is not even a part of the record—petitioner argues that the Virgin Islands will lose substantial revenue if qualified United States corporations are allowed to take the Western Hemisphere trade corporation deduction for Virgin Islands income tax purposes (Pet. 6-7).

This argument is more properly directed to Congress. It is Congress which has made the Western Hemisphere trade corporation deduction available to any qualified United States corporation conducting its business anywhere in the Western Hemisphere (outside the United States). If there is to be an exception for the Virgin Islands, it should be made by Congress. Since Congress not only has the power to alter the Virgin Islands tax law, but also has the ultimate responsibility to provide financial assistance should the territorial revenues prove to be inadequate, Congress is in the best position to evaluate the impact of any diminution in revenue resulting from the decision below and to formulate an appropriate solution.

For example, Congress may well conclude that the Virgin Islands will benefit more, economically, by continuing to give United States corporations a tax incentive to do business there than it would by allowing the territory to exact from those corporations a higher tax than the United States itself could collect. In that case, if convinced of the need, Congress could provide for revenue from other sources.

Finally, the specter of Virgin Islands corporations rushing to incorporate in the United States (to get the benefit of the Western Hemisphere trade corporation deduction on their Virgin Islands-source income (Pet. 6)) has to be

measured against the specter—if petitioner's interpretation should be upheld—of United States corporations rushing to incorporate in the Virgin Islands (to get the benefit of the Western Hemisphere trade corporation deduction on all of their United States-source income).

If the Virgin Islands is seriously concerned that the Third Circuit's decision places its corporations at a tax disadvantage, vis-a-vis United States Western Hemisphere trade corporations doing business in the Virgin Islands, § 934 of the Internal Revenue Code gives the territorial legislature the power to equalize the tax burden by granting a tax subsidy to its corporations with respect to their Virgin Islands-source income. However, that section expressly prohibits the Virgin Islands legislature from reducing its corporations' tax liability with respect to United States-source income—precisely the result which petitioner admits (Pet. 8) would follow if petitioner's substitution argument were to be accepted.

CONCLUSION

Certiorari should be denied.

Respectfully submitted,

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